

GAO

Report to the Secretary of Defense

AD-A248 052



March 1992

## CONTRACT PRICING

Threshold for Analysis  
of Subcontract  
Proposals Not Clear



92-08035



United States  
General Accounting Office  
Washington, D.C. 20548

National Security and  
International Affairs Division

B-246470

March 20, 1992

The Honorable Richard B. Cheney  
The Secretary of Defense

Dear Mr. Secretary:

This report results from our ongoing work being performed at the request of the Chairman, Senate Committee on Governmental Affairs, on the Department of Defense's (DOD) management of subcontracts. It discusses whether procurement officials make consistent and uniform interpretations of the dollar threshold at which prime contractors are required to submit analyses of cost or pricing data for prospective subcontracts—subcontract proposals that are not negotiated before prime contract negotiations with the government are completed.

Subcontracts frequently comprise more than 50 percent of prime contract prices and are often not negotiated until after DOD has negotiated the prime contract. Accordingly, the Federal Acquisition Regulation (FAR) specifies actions that contractors must take to help ensure the fairness and reasonableness of such prospective subcontract proposals. For proposals priced at or above dollar thresholds, the FAR requires prime contractors to (1) obtain and analyze cost or pricing data that supports the proposals and (2) submit the analyses to the government before an agreement is reached on the prime contract price.

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## Results in Brief

Within the DOD procurement community, officials identify two different dollar thresholds as being applicable to the FAR requirement that prime contractors analyze cost or pricing data from prospective subcontractors before an agreement is reached on the prime contract price. Some procurement officials interpret the FAR as requiring such analysis if the prospective subcontract is expected to exceed the threshold for submitting data under the Truth in Negotiations Act (P.L. 87-653), as amended, currently \$500,000. Other officials cite another FAR section on prospective subcontracts to justify a higher threshold of \$1 million or both more than \$500,000 and more than 10 percent of the prime contract value.

These different interpretations could result either in the government not receiving analyses needed to establish fair and reasonable contract prices or in contractors being burdened with analyses of subcontract proposals not required by the government. In the short term, clarifying the FAR section on analyses could eliminate confusion as to the threshold at which

prime contractors are required to analyze prospective subcontractor cost or pricing data. For the long term, determining the effects of potential thresholds for analysis of such data could be done in conjunction with the congressionally mandated DOD Inspector General review of the effect of the threshold change in the Truth in Negotiations Act.

## Background

The Truth in Negotiations Act, passed in 1962 and subsequently amended, requires contractors and subcontractors to submit cost or pricing data before award of any negotiated contract, subcontract, or amendment if the price exceeds \$500,000.<sup>1</sup> DOD and its contractors often negotiate a contract price before the contractor has negotiated prices with its subcontractors. When this occurs, prime contracts often contain estimates of what the subcontract prices might likely be based on subcontract proposals. Such subcontract proposals are referred to as prospective subcontracts.

In the late 1960s and early 1970s, DOD made regulatory changes because neither the Truth in Negotiations Act nor existing regulations required contractors to submit prospective subcontractor cost or pricing data or to analyze the data before prime contract negotiations. The subcontract data could be submitted to the prime contractor anytime prior to subcontract award, and prime contractor analysis was not required. However, DOD believed that data and analysis on significant prospective subcontracts were necessary prior to negotiating the prime contracts in order to ensure fair and reasonable prices.

In 1969, DOD issued regulations requiring contractors to submit, before the prime contract is negotiated, cost or pricing data for selected prospective subcontracts to the government. In establishing the regulation, DOD attempted to balance the burden that the additional submission requirements would have on contracting officers, prime contractors, and subcontractors with the benefits. The DOD regulatory committee established the threshold at \$1 million or both more than \$100,000 (since raised to \$500,000) and more than 10 percent of the proposed prime contract price. Section 15.806-2(a) of the FAR, in part, provides the following:

<sup>1</sup>The threshold for submitting cost or pricing data was raised from \$100,000 to \$500,000 in December 1981. The \$100,000 threshold was reinstated in 1985, was again raised to \$500,000 in the 1991 National Defense Authorization Act (P.L. 101-510), and is scheduled to return to \$100,000 in 1996. Throughout this report, we use \$500,000 to represent the Truth in Negotiations Act threshold.

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The contracting officer shall require a contractor that is required to submit certified cost or pricing data also to submit to the Government (or cause the submission of) accurate, complete, and current cost or pricing data from prospective subcontractors in support of each subcontract cost estimate that is: (1) \$1,000,000 or more, (2) both more than [\$500,000]<sup>2</sup> and more than 10 percent of the prime contractor's proposed price, or (3) considered to be necessary for adequately pricing the prime contract.

In 1972, DOD added the requirement that prime contractors analyze subcontractor cost or pricing data. Under the requirement, contractors are to perform this analysis before an agreement is reached on the prime contract price. The government can use the analysis in establishing fair and reasonable prime contract prices. However, neither the original requirement nor the current requirement states a dollar threshold for the analysis. Section 15.806-1(a)(2) of the FAR provides the following:

Subcontractors must submit to the contractor or higher tier subcontractor, cost or pricing data or claims for exemption from the requirement to submit them. The contractor and the higher tier subcontractor shall: (i) conduct price analyses and, when the subcontractor is required to submit cost or pricing data, or if the contractor or higher tier subcontractor is unable to perform an adequate price analysis, cost analyses for all subcontracts, (ii) include the results of these analyses as part of their own cost or pricing data submission, and (iii) when required, in accordance with 15.806-2(a), submit the subcontractor cost or pricing data as part of their own cost or pricing data submission.

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## Differing Interpretation of Analyses Threshold

DOD procurement officials have different interpretations regarding the dollar threshold at which the FAR requires analysis of prospective subcontractor cost and pricing data. Some DOD officials interpret the regulatory language as requiring the analysis at the threshold for cost or pricing data specified in the Truth in Negotiations Act. As noted earlier, this threshold has been \$100,000 and \$500,000 at various times. Others believe that the analysis is required to be submitted only at the higher threshold of \$1 million or both more than \$500,000 and more than 10 percent of the prime contractor's proposed price. Under the higher threshold, analysis would not be required for prospective subcontract proposals of less than \$1 million if the prime contract value exceeded \$10 million.

Officials of 15 major DOD procuring offices (listed in app. I), in response to our written request, identified the dollar threshold at which they required

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<sup>2</sup>Federal Acquisition Circular 90-10, effective December 30, 1991, changed the FAR threshold from \$100,000 to \$500,000 for DOD, Coast Guard, and National Aeronautics and Space Administration contracts and subcontracts.

prime contractors to submit analyses of prospective subcontract price proposals. Their responses indicate about an even split in interpretations of the threshold, as shown in table 1.

**Table 1: Threshold Identified by Procuring Offices**

Threshold	Number of responses
\$500,000	7
\$1 million or both more than \$500,000 and more than 10 percent	6
Other <sup>a</sup>	2
<b>Total</b>	<b>15</b>

<sup>a</sup>One office said that analyses were required of all subcontracts regardless of dollar amount. The other said that it relied upon government audits of prospective subcontract proposals of \$1 million or more.

Four of the respondents furnished local guidance that identified a dollar threshold for analysis of subcontract proposals, with three specifying the \$1 million threshold.

Representatives of the Defense Contract Audit Agency, the DOD Inspector General, the Office of the Director of Defense Procurement (Cost, Pricing, and Finance), and the Defense Contract Management Command interpret the FAR provisions as requiring subcontract cost analyses at the \$500,000 threshold. The chairman of the DOD committee that drafted the regulation on prospective subcontract data in the late 1960s interprets the current FAR as requiring analyses of prospective subcontractor cost or pricing data at the \$1 million or both more than \$500,000 and more than 10 percent threshold. He believes that this is consistent with the original regulatory language.

Limited inquiries of defense contractors and information on contractors' written cost-estimating policies and practices disclosed general agreement among contractors on the higher threshold—\$1 million or both more than \$500,000 and more than 10 percent of the prime contract value.

## Threshold Affects Data, Burden, and Compliance

The threshold is important to sound contract pricing. If it is too high, subcontract cost estimates could be excluded from analyses that are needed to establish fair and reasonable prime contract prices. If the threshold is too low, unnecessary and costly burdens could be placed on prime contractors and subcontractors without corresponding benefits to the government. Also, a threshold that is confusing or ambiguous affects

adherence to the requirements by procurement officials of both the government and contractor.

A major deficiency identified in recent reports by the Defense Contract Audit Agency, the DOD Inspector General, and our office has been contractors' failure to conduct required analyses of subcontractor cost or pricing data. Contractors generally attribute noncompliance with analyses requirements to time and cost constraints. However, noncompliance can be costly to DOD. For example, our April 1991 review of three prime contracts showed that DOD paid about \$8.8 million in excess prices primarily because noncompetitive subcontract proposals had not been evaluated prior to prime contract price agreement.<sup>3</sup> Although our report focused on subcontracts over \$1 million, similar problems have been identified for subcontracts with a lower value.

DOD's regulatory committee that established the threshold for prospective subcontractor cost or pricing data considered the number of subcontracts that would be included or excluded at various thresholds. For a limited number of prime contracts, the committee compared the number of subcontracts between \$100,000 and \$1 million with the number over \$1 million and found that 90 percent of the subcontracts were priced between \$100,000 and \$1 million. This comparison involved prime contracts in the 1960s. In table 2, we show the dollar value and number of subcontracts for four prime contracts that are more recent to illustrate the effects of various dollar thresholds.

**Table 2: Number and Dollar Value of Subcontracts**

Dollar value range	Subcontracts		Value (millions)	Percentage of total value
	Number	Percent		
\$100,000 to \$500,000	99	58	\$23	8
\$500,001 to \$1 million	28	17	19	7
Over \$1 million	42	25	236	85
<b>Total</b>	<b>169</b>	<b>100</b>	<b>\$278</b>	<b>100</b>

For these contracts, 75 percent of the subcontracts are priced between \$100,000 and \$1 million. If the threshold for subcontract analysis was \$500,000, the prime contractors would be required, prior to price agreement, to analyze 70 data packages, valued at \$255 million. If the

<sup>3</sup>Contract Pricing: Inadequate Subcontract Evaluations Often Lead to Higher Government Costs (GAO/NSIAD-91-161, Apr. 5, 1991).

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threshold was \$1 million, analysis of 42 packages valued at \$236 million would be required, but analysis on the remaining 127 subcontracts valued at \$42 million would not be required.

In 1990, when the Congress increased the Truth in Negotiations Act threshold from \$100,000 to \$500,000, it required the DOD Inspector General to review the effects of the increase and to report the results to the Secretary of Defense. The Secretary is to submit the report and any appropriate comments to the Congress. Matters to be reviewed include "whether increasing the threshold has improved the acquisition process in terms of reduced paperwork, financial or other savings to the government, an increase in the number of contractors participating in the defense contracting process, and the adequacy of information available to contracting officers in cases in which certified cost or pricing data are not required..." The report is to be submitted to the Congress by January 1995.

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## Recommendations

We recommend that you

- direct the Defense Acquisition Regulatory Council to clarify the regulatory threshold at which prime contractors are required to analyze prospective subcontractor cost or pricing data and provide the results to the government before prime contract price agreement and
- request the Inspector General to evaluate, in conjunction with the congressionally mandated review of the effects of the threshold increase in the Truth in Negotiations Act, the effects of alternative potential thresholds for analysis of prospective subcontract data before prime contract price agreement.

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## Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD took the position that the threshold for prime contractors to analyze subcontractor cost or pricing data should be the same threshold at which submission of subcontractor cost or pricing data is required, currently \$500,000. DOD also indicated that (1) clarifying FAR wording on the threshold would be developed and submitted within 60 days and (2) the DOD Inspector General would consider, for the fiscal year 1993 audit plan, an evaluation of compliance with FAR requirements for performing cost analyses and submitting subcontractor cost or pricing data.

Although the indicated DOD Inspector General compliance evaluation may be useful, we believe it would contribute little to determining an optimum

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threshold. We continue to believe that a study is needed to determine the effects of alternative potential thresholds. For example, a study could show the effects of (1) the scheduled threshold decrease to \$100,000 or (2) the higher \$1 million threshold that some interpret as being applicable.

DOD's written comments are reprinted in their entirety in appendix II.

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## Scope and Methodology

We reviewed regulatory requirements on cost or pricing data and related threshold requirements for analyses of subcontract proposals. We also reviewed the DOD regulatory committee's case files and held discussions with the former chairman and other members to identify the objective and rationale in establishing the dollar thresholds.

To identify interpretations within the DOD procurement community of the dollar threshold for prime contractor analyses of prospective subcontractor data, we sent written inquiries to 15 major DOD procuring offices and held discussions with headquarters officials at the Defense Contract Audit Agency, Defense Contract Management Command, DOD Inspector General, and the Office of the Director of Defense Procurement, (Cost, Pricing, and Finance). We also reviewed selected audit and evaluation reports made by these offices. We made limited inquiries of contractors and reviewed data on contractors' policies and practices to obtain insights regarding their interpretations of the threshold. Finally, we developed data on four contracts to illustrate the potential effect of different thresholds. However, these contracts are not representative, and data are provided only as an example.

We performed our review from March to November 1991 in accordance with generally accepted government auditing standards.

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As the head of a federal agency, you are required by 31 U.S.C. 720 to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

Copies of this report are being sent to the Chairmen, Senate Committee on Governmental Affairs, House Committee on Government Operations, and

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the House and Senate Committees on Armed Services; Secretaries of the Army, the Navy, and the Air Force; Commander, Defense Contract Management Command; Director, Defense Contract Audit Agency; and Inspector General, DOD. We will also make copies available to other interested parties upon request.

Please contact me at (202) 275-8400 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix III.

Sincerely yours,



Paul F. Math  
Director, Research, Development, Acquisition,  
and Procurement Issues



# DOD Procuring Offices Queried on Threshold for Prospective Subcontracts

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## Army

Armament, Munitions, and Chemical Command, Rock Island, Ill.  
Aviation Systems Command, St. Louis, Mo.  
Communications and Electronics Command, Ft. Monmouth, N.J.  
Missile Command, Redstone Arsenal, Ala.  
Tank-Automotive Command, Warren, Mich.  
Troop Support Command, St. Louis, Mo.

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## Navy

Naval Air Systems Command, Washington, D.C.  
Naval Sea Systems Command, Washington, D.C.  
Space and Naval Warfare Systems Command, Washington, D.C.  
Strategic Systems Programs, Washington, D.C.

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## Air Force

Aeronautical Systems Division, Wright-Patterson  
Air Force Base, Ohio  
Ballistic Missile Organization, Norton Air Force Base, Calif.  
Development Test Center, Eglin Air Force Base, Fla.  
Electronic Systems Division, Hanscom Air Force Base, Mass.  
Space Systems Division, Los Angeles, Calif.

# Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



## OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

JAN 29 1992

Mr. Frank C. Conahan  
Assistant Comptroller General  
National Security and International  
Affairs Division  
U.S. General Accounting Office  
Washington, DC 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report "CONTRACT PRICING: Threshold for Analysis of Subcontract Proposals Not Clear," dated December 19, 1991 (GAO Code 396680/OSD Case 8908). The Department only partially agrees with the report.

The Department disagrees that the current Federal Acquisition Regulation is unclear with respect to the dollar threshold for prime contractors to analyze subcontractor cost or pricing data. However, in view of the results of the GAO inquiry of Defense contractors and its analysis of the information on contractors' written cost-estimating policies and practices, proposed clarifying wording to the Federal Acquisition Regulation will be developed.

Concerning expanding the congressionally mandated review, the Congress did not direct that the Inspector General, DoD, review threshold changes to the Truth in Negotiations Act. Rather, the Congress directed that the Inspector General conduct a review of the effects of the increase in the threshold for submission of cost or pricing data after the increase has been in effect for three years. It is the Department position that the threshold for prime contractors to analyze subcontractor cost or pricing data should be the same threshold at which the submission of subcontractor cost or pricing data is required. However, a separate review might be indicated as to the extent of compliance with the Federal Acquisition Regulation requirements for (1) performing cost analyses, and (2) submission of subcontractor cost or pricing data. Such a review will be considered by the Office of the Inspector General, DoD, for inclusion in the FY 1993 audit plan.

See comment 1.

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**Appendix II**  
**Comments From the Department of Defense**

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The detailed DoD comments are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

*Eleanor Spector*

Eleanor R. Spector  
Director, Defense Procurement

Enclosure

GAO DRAFT REPORT—DATED DECEMBER 19, 1991  
(GAO CODE 396680) OSD CASE 8908

"CONTRACT PRICING: THRESHOLD FOR ANALYSIS OF  
SUBCONTRACT PROPOSALS NOT CLEAR

DEPARTMENT OF DEFENSE COMMENTS

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FINDINGS

**FINDING A: The Truth in Negotiations Act.** The GAO observed that the Truth in Negotiations Act, passed in 1962 and subsequently amended, requires contractors and subcontractors to submit cost or pricing data before award of any negotiated contract, subcontract, or amendment, if the price exceeds \$500,000. The GAO explained that the DoD and its contractors often negotiate a contract price before the contractor has agreed to prices with its subcontractors. The GAO noted that, when such a situation occurs, prime contracts often contain estimates of what the subcontract prices might likely be, instead of the actual negotiated amount of the subcontracts. The GAO indicated that such subcontract proposals are referred to as prospective subcontracts.

The GAO reported that, in the late 1960s and early 1970s, the DoD initiated regulatory changes because neither the Truth in Negotiations Act nor existing regulations required contractors (1) to submit prospective subcontractor cost or pricing data or (2) to analyze the data before prime contract negotiations. The GAO pointed out that, under the Act and regulatory requirements then in effect, the subcontract data could be submitted anytime prior to subcontract award. The GAO observed that it was the DoD position that, to ensure fair and reasonable prices, data and analysis on significant prospective subcontracts were necessary prior to the award of prime contracts.

The GAO further observed that, in 1970, the DoD issued regulations requiring contractors to submit cost or pricing data for selected prospective subcontracts to the Government. The GAO emphasized that, in developing the regulations, the DoD attempted to balance the burden the additional submission requirements would have on contracting officers, prime contractors, and subcontractors—with the anticipated benefits. The GAO reported that the committee established the threshold at \$1 million or both more than \$100,000 (since raised to \$500,000) and 10 percent of the proposed prime contract price.

The GAO pointed out that, in 1972, the DoD added the requirement that prime contractors must analyze subcontractor cost or pricing data. According to the GAO, that change requires contractors to perform the

Enclosure

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**Appendix II**  
**Comments From the Department of Defense**

Now on pp. 2-3.

See comment 2.

analysis before an agreement is reached on the prime contract price. The GAO indicated that the Government can then use the analysis in establishing fair and reasonable prime contract prices. The GAO found, however, that neither the original requirement nor the current requirement state a dollar threshold for the analysis. (pp. 2-4/GAO Draft Report)

**DOD RESPONSE:** Partially concur. The DoD disagrees that the current Federal Acquisition Regulation (FAR) does not explicitly state a dollar threshold for prime contractors to analyze subcontractor cost or pricing data. FAR 15.804-2(a)(1)(iii) states that any subcontract expected to exceed \$100,000 <sup>1/</sup> requires the submission of certified cost or pricing data. FAR 15.806-1(a)(2) further requires that the contractor and the higher tier subcontractor conduct cost analyses for subcontracts when the subcontractor is required to submit cost or pricing data, and include the results of these analyses as part of their own cost or pricing data submission.

**FINDING B: Differing Interpretation of Analyses Threshold.** The GAO found that DoD procurement officials have different interpretations regarding the dollar threshold at which the FAR requires analysis of prospective subcontractor cost or pricing data. The GAO concluded that some DoD officials interpret the regulatory language as requiring the analyses at the threshold for cost or pricing data specified in the Truth in Negotiations Act. The GAO noted that threshold had, at various times, been \$100,000 and \$500,000. The GAO pointed out that other DoD officials believe that the analyses is required to be submitted only at the higher threshold of \$1 million or both \$500,000 and 10 percent of the proposed price of the prime contractor. The GAO explained that, under the higher threshold, analysis would not be required for prospective subcontract proposals of less than \$1 million, if the prime contract value exceeded \$10 million.

According to the GAO, officials of 15 major DoD procuring offices responded to a GAO inquiry to identify the dollar threshold at which they required prime contractors to submit analyses of prospective subcontract price proposals. The GAO reported that the inquiry responses indicated about an even split in interpretations of the thresholds.

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1. Federal Acquisition Circular 90-10 will increase the threshold to \$500,000 for the DoD, the National Aeronautics and Space Administration, and the Coast Guard, for the submission of subcontract cost or pricing data, and the analysis of such data by the prime contractor. That change is consistent with Public Law 101-510, which amended Title 10, U.S. Code, Section 2306a(a)(1), by raising the threshold for submission of cost or pricing data from \$100,000 to \$500,000 and Public Law 102-190 which further amended Section 2306a(a)(1) to apply the \$500,000 threshold to subcontracts awarded after December 5, 1991, under prime contracts entered into on or before December 5, 1990, if the prime contract is modified to incorporate the \$500,000 threshold.

Now on pp. 3-4.

See comment 3.

The GAO pointed out that the Defense Contract Audit Agency, the Office of the Inspector General, DoD, the Office of the Director of Defense Procurement (Cost, Pricing, and Finance), and the Defense Contract Management Command interpret the FAR provisions as requiring subcontract cost analyses at the \$500,000 threshold. The GAO found, however, that the chairman of the DoD committee, which drafted the regulation on prospective subcontract data in the late 1960s, interprets the current FAR as requiring analyses of prospective subcontractor cost or pricing data at the \$1 million or both more than \$500,000 and 10 percent threshold. According to the GAO, the former chairman maintains that his interpretation is consistent with the original regulatory language.

The GAO observed that limited inquiries of defense contractors and information on contractors' written cost-estimating policies and practices disclosed consistent agreement on the threshold--\$1 million or both \$500,000 and 10 percent of the prime contract value.  
(pp. 4-6/GAO Draft Report)

**DOD RESPONSE:** Partially concur. It is the DoD view that the FAR already is clear regarding when prime contractors are required to submit analyses of prospective subcontractor cost or pricing data. FAR 15.806-1(b) states that any contractor required to submit certified cost or pricing data must also obtain certified cost or pricing data before awarding any subcontract or purchase order expected to exceed \$100,000 (see footnote 1). FAR 15.806-1(a)(2) requires that the contractor and the higher tier subcontractor conduct cost analyses for all subcontracts when the subcontractor is required to submit cost or pricing data--and to include the results of such analyses as part of their own cost or pricing data submissions. FAR 15.806-2 further requires contractors to submit to the Government cost or pricing data from prospective subcontracts in support of each subcontract cost estimate that is (1) \$1,000,000 or more, (2) both more than \$100,000 (see footnote 1) and more than 10 percent of the prime contractor's proposed price, or (3) considered to be necessary for adequately pricing the prime contract.

**FINDING C: Threshold Affects Data, Burden, and Compliance.** The GAO pointed out that the threshold is important to sound contract pricing. According to the GAO, if the threshold is too high, subcontract cost estimates could be excluded from analyses that are needed to establish fair and reasonable prime contract prices. The GAO added that, if the threshold is too low, unnecessary and costly burdens could be placed on prime contractors and subcontractors without corresponding benefits to the Government. The GAO also noted a threshold that is confusing or ambiguous would affect adherence to the requirements by procurement officials of both the Government and contractor.

The GAO observed that a major deficiency identified in recent reports by the Defense Contract Audit Agency, the Office of the Inspector General, DoD, and the GAO has been the failure of contractors to

conduct required analyses of subcontractor cost or pricing data. The GAO found that the contractors generally attribute noncompliance with analyses requirements to time and cost constraints. The GAO concluded, however, that noncompliance can be costly to DoD. The GAO cited an April 1991 report (OSD Case 8708), in which it had concluded that DoD paid about \$8.8 million in excess prices primarily because noncompetitive subcontract proposals were not evaluated prior to prime contract price agreement. The GAO noted that, while the prior report focused on subcontracts over \$1 million, similar problems have been identified for subcontracts with a lower value.

The GAO pointed out that, when the Truth in Negotiations Act threshold was recently increased from \$100,000 to \$500,000, the Congress also required analysis of the effects of different thresholds--directing the Office of the Inspector General, DoD to (1) review the effects of the increase and (2) report the results to the Secretary of Defense, who is to submit the report and appropriate comments to the Congress. The GAO noted that matters to be reviewed include "whether increasing the threshold has improved the acquisition process in terms of reduced paperwork, financial or other savings to the Government, an increase in the number of contractors participating in the defense contracting process, and the adequacy of information available to contracting officers in cases in which certified cost or pricing data are not required..." The GAO further noted that the report is to be submitted to the Congress by January 1995. (pp. 6-9/GAO Draft Report)

Now on pp. 4-6.

DOD RESPONSE: Concur.

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#### **RECOMMENDATIONS**

**RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense direct the Defense Acquisition Regulations (DAR) Council to clarify the regulatory threshold at which prime contractors are required to analyze prospective subcontractor cost or pricing data and provide the results to the Government before prime contract price agreement. (p. 9/GAO Draft Report)

Now on p. 6.

**DOD RESPONSE:** Concur. Although it is the DoD view that the current FAR is already specific as to the thresholds, in view of the results of the GAO inquiry (albeit limited), proposed clarifying wording to the FAR will be developed and submitted to the DAR Council within the next 60 days.

**RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense request the Inspector General, Department of Defense, to evaluate--as part of the congressionally mandated review of threshold changes in the Truth in Negotiations Act--the effects of potential thresholds for analysis of prospective subcontract data before prime contract price agreement. (p. 9/GAO Draft Report)

Now on p. 6.

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**Appendix II**  
**Comments From the Department of Defense**

Now on p. 5.

**DOD RESPONSE:** Partially concur. The Congress did not mandate that the Inspector General, DoD, review threshold changes in the Truth in Negotiations Act, but rather directed the Inspector General conduct a review of the effects of the increase in the threshold for submission of cost or pricing data after the increase has been in effect for three years. It is the Department position that the threshold for prime contractors to analyze subcontractor cost or pricing data should be the same threshold at which the submission of subcontractor cost or pricing data is required. Draft report table 2 (page eight) shows the dollar value and number of subcontracts for four prime contracts to illustrate the effects of selecting various dollar thresholds for analysis of subcontractor cost or pricing data. According to table 2, if the threshold for analysis was established at \$500,000 or more, 92 percent of the total value of the prospective subcontracts would be analyzed by prime contractors, while only 42 percent of subcontract actions in the same sample would be analyzed. Establishment of the threshold at that level represents the optimum choice available to the Department in terms of high dollar coverage, yet low number of actions covered.

However, in view of the GAO-identified confusion concerning the thresholds for prime contractor cost analysis of subcontractor proposals, it would be appropriate for the Inspector General, DoD, to evaluate the extent of compliance with the Federal Acquisition Regulation requirements for (1) performing cost analyses, and (2) submission of subcontractor cost or pricing data. Such a review will be considered for the Inspector General FY 1993 audit plan.

The following are GAO's comments on DOD's letter dated January 29, 1992.

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## **GAO Comments**

1. We have added words in the report to clearly state that the Congress directed the Inspector General to conduct a review of the effects of the increase in the threshold rather than the threshold changes.
2. FAR section 15.804-2(a)(1)(iii) referred to by DOD addresses submission of data prior to award of the subcontract. However, as our report notes, many subcontracts are not negotiated until after the prime contract is negotiated. FAR does not state a dollar threshold for analysis of these prospective subcontracts. The differing interpretations that this allows are the basis for our recommendation to clarify the threshold.
3. DOD references are to the same FAR sections discussed in our report. These are the sections that led to the differing interpretations and are the basis for our recommendation to clarify the threshold. DOD has agreed to propose new regulatory wording within the next 60 days.

# Major Contributors to This Report

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